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REPORT OF THE EXPERT MEETING ON THE IMPACT OF FDI POLICIES ON INDUSTRIALIZATION, LOCAL ENTREPRENEURSHIP AND THE DEVELOPMENT OF SUPPLY CAPACITY

Held at the Palais des Nations, Geneva
5 to 7 November 2001

CONTENTS

Chapter **Page**

I. Outcome of the Expert Meeting 2

II. Chairperson's summary 7

III. Organizational matters 17

Annex

Attendance 19

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Chapter I

OUTCOME OF THE EXPERT MEETING

1. The Expert Meeting on the Impact of FDI Policies on Industrialization, Local Entrepreneurship and the Development of Supply Capacity examined the policy issues related to: (a) the link between foreign direct investment (FDI) and industrialization, export competitiveness and development of supply capacity; (b) FDI promotion in the context of development strategies; (c) specific instruments and tools for FDI targeting; and (d) the promotion of backward linkages to support local entrepreneurship and development of supply capacity.

2. The experts noted that:

(a) Most Governments acknowledge today that FDI can provide important benefits to host countries. It is clear that, in some countries and under certain circumstances, FDI can help enhance export competitiveness and support industrialization strategies. The extent to which FDI contributes to these goals depends on many factors, including the corporate strategies that drive the FDI, as well as the degree of leverage achieved by policy makers and firms in the host economy from the linkages established. Benefits are not automatic, and countries need to create the appropriate conditions for the realization of the potential benefits.

(b) Increasingly, in a globalizing world, transnational corporations are playing a decisive role in the global distribution of production and trade. In many of the developing countries that have had the greatest increases in their share of world exports of manufactures, attracting the right type of FDI has been central to their success.

(c) The policy issues confronting developing countries that are searching for ways to use FDI as a means of boosting their export competitiveness vary, depending on their level of development, the sectors targeted and the resources available. However, all countries need to define from the outset clear policy objectives and to establish an FDI promotion framework consistent with each country's capacities and opportunities. Policies play an important role not only in attracting the kind of FDI which helps to develop industries that correspond to, and utilize, the dynamic comparative advantage of host countries, but also in spreading the benefits derived from FDI through linkages with domestic enterprises, thereby enhancing their supply capacity and eventually providing them with an opportunity to become global suppliers.

3. On the basis of the exchanges of experience during the Expert Meeting, some elements of best practice in the design of FDI promotion policies and policies to promote backward linkages could be considered.

4. First, there is a need to achieve political stability and a favourable environment for private sector activities, which may involve simply relaxing excessive restrictions, introducing new laws and regulations, or reinterpreting existing ones that can facilitate business.

5. A targeted FDI promotion approach would imply:

(a) A focus on a few competitive sectors and industries;

(b) A matching of countries' advantages with investors' interests;

(c) An effort to create value added and leverage through foreign investment.

6. A targeted approach is an ongoing process and should develop with countries' evolving objectives and advantages.

7. Targeted companies could be those which:

(a) Already have a presence in the host economy;

(b) Are part of the supply chain;

(c) Are users of countries' own resources, including raw materials and human skills;

(d) Are active in strong production sectors with growth opportunities;

(e) Help to establish new core competencies.

8. The tools to target investment have evolved, from cost reduction tools to differentiation and specialization. Government incentives, including tax incentives, can play a role. The tools often found to be effective include:

(a) Clusters;

(b) Public private partnerships;

(c) Alliances;

(d) Aftercare for existing investors;

(e) Subnational agglomeration.

9. In many countries, clustering has become an important targeting mechanism. It sometimes involves using or establishing research and development facilities, a network of small and medium-sized enterprises (SMEs) and a good public utilities infrastructure.

10. Belonging to a preferential trade area or having access to larger markets can be an advantage in attracting FDI.

11. Consideration could be given to promoting an efficient linkage programme which would take into account the following aspects:

(a) The need for matchmaking to be complemented by measures to upgrade local supply capacity;

(b) The need for supplier development efforts to be selective and target SMEs that show the greatest potential for growth;

(c) Cooperation and coordination among the various government agencies;

(d) Efforts to make SME development tally with FDI policies;

(e) Reliance on the best business service providers, whether public or private;

(f) The need for measures to be context-specific, and appropriate to the circumstances of each country or subnational location.

A. Governments

12. Governments are encouraged to consider cost-efficient ways of promoting FDI policies that are consistent with their country's overall development objectives and industrialization strategies, fully involving the private sector and reconciling foreign investors' motives with the country's priorities. While government leadership in providing a clear vision of a development strategy is the starting point, a public–private sector partnership is both helpful and necessary during the implementation stages.

13. Coordination among government agencies and departments, and a simplified institutional setting consisting of a lead agency for FDI promotion, are also highly recommended.

14. A targeted approach is recommended in designing FDI promotion policies, as it represents the most efficient use of limited resources, offers the best prospects for success, and helps to achieve strategic goals.

15. To increase the beneficial leverage of FDI on the host economy, Governments need to pay special attention to developing local supplier programmes, and to upgrading the technology and capacity of local suppliers.

16. Governments should examine the key elements of a linkage promotion programme, as summarized in the following steps:

(a) Setting the policy objectives, in line with the country's overall development strategy;

(b) Identifying the targets of the programme: selection of industries, foreign affiliates and domestic firms;

(c) Identifying the specific measures to be adopted, in terms of information and matchmaking, technology and technical assistance, training and provision of finance;

(d) Setting up an institutional and administrative framework to implement and monitor the programme.

17. It was suggested by some experts that developing countries should accelerate the privatization of the electricity, water and telecommunications sectors with complete transparency.

18. Home countries should share experiences in targeting and linkage promotion, and assist in this respect.

19. Improved access to developed country markets, especially for products from the least developed countries and low-income countries, can help those countries to attract FDI.

20. Home countries are also encouraged to provide financial assistance to developing countries, particularly those with limited resources, for the establishment of an appropriate framework for FDI promotion and linkage development.

21. Outward FDI agencies in developed countries could serve as vehicles for supporting FDI in developing countries, for example by liaising with investment promotion agencies in those countries and disseminating information.

B. The international community

22. International institutions dealing with FDI should assist developing countries and countries in transition in setting up an appropriate institutional framework for FDI policies and targeting, including the formation of clusters.

23. Cooperation and coordination among United Nations agencies and other relevant institutions on these issues are desirable.

24. The international community should assist the least developed countries in building and improving the infrastructure necessary for attracting FDI.

C. UNCTAD

25. UNCTAD should:

(a) Continue to analyse the international systems of production, by sector and industry, and make this information available to member countries;

(b) Assist developing countries in assessing their existing capabilities in order to help them define policy goals in line with their competitive situation in the international market;

(c) Help developing countries to design, implement and monitor FDI targeting and linkage programmes consistent with their industrialization and development strategies.

Chapter II

CHAIRPERSON'S SUMMARY

A. Industrialization, export competitiveness, development of supply capacity and FDI

26. The main development question for the experts was what types of policies should be considered for implementing an industrialization strategy that was export-oriented and used foreign direct investment (FDI) as a catalyst. Country experiences in this regard varied widely: some economies relied on exports generated by domestically owned industries, while others applied a strategy more reliant on FDI, which serviced assembled or manufactured exports for regional or international markets. A number of countries that had adopted the latter strategy had made remarkable progress in export competitiveness through integration into the international production systems of transnational corporations (TNCs).

27. The economic performance of a number of Asian, Latin American and transition economies suggested that the export- and FDI-oriented development path could indeed be successful, harnessing available technology and moving up the value chain systematically. Various statistical analyses showed the increased export exposure in world markets of a number of developing economies, and also the relevance of FDI as a means of achieving industrial development.

28. Among the examples identified were China and several South-East and East Asian economies, which had shown impressive gains in world market shares during the past 15 years and had changed the structure of their exports from low- to high-tech products on the basis of proactive government policies. Similarly, in Latin America, Mexico had increased the share of its exports in non-resource-based manufacturing and mid- and high-tech products, while Costa Rica had achieved a dramatic increase in non-resource-based manufacturing and started the production and export of high-tech products as a result of a large inward FDI (by Intel). In Central and Eastern Europe also, countries such as Hungary and the Czech Republic had substantially increased their export market shares in the 1990s, and shifted from low- to high-tech exports, largely as a result of proximity to European Union (EU) markets and incoming FDI.

29. The policies and strategies adopted in several of those countries were examined in detail. China, for example, had recently begun emphasizing higher-value-added FDI. During preceding phases of the country's FDI policies (1979–1991), the focus had been on attracting labour-intensive FDI into the then newly created Special Economic Zones. In the first phase, from 1979 to 1983, China started liberalizing FDI and created the Special Economic Zones. TNCs were attracted both by the country's relatively low-cost labour and by the comprehensive set of special incentives offered by the Zones. In the second phase, from 1984 to 1991, FDI slowed down somewhat and new measures were introduced to encourage inward FDI, with reliance mostly on tax incentives. In the third phase (from 1992 onwards),

China's FDI policy underwent substantial strategic changes. These included in particular a gradual shift towards stimulating FDI not merely in the Special Economic Zones, but also in other regions. Since the year 2000, investment promotion in China had been especially focused on attracting higher-value-added and more technology-intensive FDI, while at the same time encouraging outward FDI by Chinese firms to further foster their competitiveness. As a result of these FDI policies, China had experienced impressive increases in exports, which had shifted in recent years from labour-intensive to more technology- and capital-intensive activities. This shift was also explained, in part, by the increasing share of FDI that was oriented towards producing for the domestic market as opposed to purely export-oriented FDI. Another result of the process was that the industrial structure of the Chinese economy had changed with regard to ownership. The importance of State-owned enterprises in domestic industrial production had decreased in favour of joint ventures with foreign participation. In the context of China's accession to the World Trade Organization, a fourth phase of FDI policies was emerging that would further accentuate the trend towards more technology- and capital-intensive forms of FDI.

30. In the industrialization process in Malaysia, the Government's FDI policies were consistently based on a development strategy vision. The focus of those policies evolved from the attraction of labour-intensive and export-oriented FDI in the early 1970s to the technological upgrading of manufacturing facilities, moving into higher-value-added and higher-wage activities such as product development and distribution. A similar sequence was initiated in Costa Rica, which had rapidly moved into such areas as product and software design and new technologies in general.

31. In the case of Mexico, the growth in exports (and imports) throughout the 1990s was clearly led by non-oil export activities, particularly exports of manufacturing goods, most of which were produced by affiliates of TNCs. This growth had contributed to the growth of the country's gross domestic product and to job creation. The FDI inflows were largely due to the North American Free Trade Agreement, but the country's success was not solely because of its geographical proximity to the North American markets, but also a result of its efforts to diversify trading partners from different regions (e.g. Central and South America, and Asia) through numerous bilateral free-trade and investment agreements. With the change in 1993 to a liberalized FDI policy, FDI inflows into the country – mostly FDI from the United States in the manufacturing sector – had increased threefold (from 1994 to 2000). In this connection, the Meeting noted the changing objectives of efficiency-seeking foreign investors (i.e. from a focus on low labour costs to attention to more highly skilled labour), the extension of international production systems and the intense competition from Asian economies, competing for FDI flows and to export to the United States market.

32. Mexico would continue to concentrate on export promotion and negotiation of international trade agreements as its main industrial development policies, while improving the country's comparative advantages – its young population, privileged geographical location and a worldwide network of trade agreements – to reap the benefits of free trade and investment. It would also increase the number of sectors, regions and enterprises participating in export activities and would develop local supplier programmes to increase the local

content in exports. Special attention would be devoted to developing and upgrading small and medium-sized enterprises (SMEs) in the southern provinces and to strengthening ties to other Central American countries.

33. In the Russian Federation, the transition process was still under way, and the Government was focusing attention on establishing trust among potential investors – domestic and foreign – and on overcoming macroeconomic imbalances. A Consultative Board on FDI was created in 1995; it was chaired by the President and comprised representatives of the Ministry of Finance, the Central Bank, the Ministry of State Monopolies and other national and regional government bodies, three dozen large TNCs and the Russian Chamber of Industry. A new law on FDI was adopted in 1999. Inflows were generally market-seeking – as opposed to export-oriented – and directed to heavy industry and the food industry, but also increasingly to high-technology industries (e.g. Intel) and to trade.

34. A current preoccupation of policy makers in developing and transition economies was the effect of the recent cyclical slowdown in the world economy, coupled with the effects of the restructuring of global industries such as electronics and information technology on future FDI flows. Some TNCs were reportedly putting new investment projects on hold, while others such as Intel and Cisco were turning increasingly to cost-saving measures such as outsourcing or relocation to alternative, low-cost investment sites. In general, TNCs – like all investors – were more easily attracted to dynamic markets with strong growth.

35. The Meeting noted that the experiences of those economies that had utilized FDI efficiently needed to be studied carefully. Latecomers to industrialization could not simply replicate such outward-oriented growth experiences: they needed to build specific competitive advantages and to adopt those policies and strategies that suited their resource and skill endowments. For example, less developed countries and least developed countries might follow strategies built on resource-based as opposed to technology-based exports. They might aim at increasing the degree of processing and the knowledge content of exports. Chile and Benin at different stages of production were mentioned as examples of countries which specialized in less dynamic commodity sectors but which, by developing higher-value-added activities through industrial policy measures, were entering processed product markets. The need for proactive government policies towards foreign investors was clear, since these could facilitate the upgrading of industries to higher-value-added production.

36. Common elements in cases of internationally competitive industrialization appeared to include:

(a) Active government policies, including a clear vision and strategy regarding the industrialization process, and ensuing action;

(b) Development of export markets, ideally through preferential market access for developing countries but also through active negotiation of trade agreements (the role of the American Growth and Opportunity Act for African developing countries was cited as an example in this connection);

(c) Integration into the international production systems through inward FDI and, where possible, outward FDI.

B. The role of corporate strategies and other considerations of foreign investors

37. A thorough understanding of international production systems and TNC strategies was acknowledged as essential for successful implementation of industrialization and export policies using FDI as a catalyst. It was noted that TNCs operating in dynamic markets, characterized by short product life cycles, were primarily concerned with a rapid start-up (i.e. becoming operational in a new location within three months), the speed of innovation, and the speedy production and distribution of the final product with minimal inventories. In fact, in such industries, speed was reportedly more important than the size of a firm, and the key to success could be described as being fast and flexible in adapting to changing markets and changing customer requirements. This might well be compatible with an absence of a specific product- or market-oriented corporate strategy. In the long term, as regards typical contractual manufactures, the trend towards outsourcing might prevail. As far as smaller TNCs were concerned, their success was driven substantially by their ability to take advantage of the World Wide Web or inter-firm linkages.

38. In addition to political stability and the absence of corruption, foreign investors carefully gauged the following factors when selecting an investment location:

(a) Availability of public utilities infrastructure (water, sewage, electricity);

(b) A one-stop window for foreign investors;

(c) Presence of SMEs as potential suppliers (local/foreign) and notably suppliers with certified quality and performance standards;

(d) Ease of access to and low cost of land, and simple and timely construction approvals;

(e) Availability of skilled human resources and access to accumulated know-how;

(f) Flexibility of labour markets (adaptability to shifts in production and seasonal production);

(g) Consistent trade policies and legislation, notably on export processing zones (EPZs), and efficient customs clearance procedures;

(h) Assured access to the main destination markets;

(i) A stable and predictable tax environment, including reliable stable incentives, if any (tax holidays being of secondary importance);

(j) Capital and profit repatriation, and stable exchange rates;

(k) Quick and simple expatriate regulations, and appropriate housing etc.

39. In Costa Rica, for example, foreign investors such as Intel had based their investment decision on the existence of a skilled labour force and the availability of research facilities. In the case of Hungary, where Flextronics had made its largest investment (measured against the size of the country), the investment had been triggered by the country's proximity to Western European markets (mainly EU markets), a low-wage but highly skilled labour force, confidence in government and society, and the ease of doing business and securing government support. Measures provided by the Government included industrial parks, duty-free zones and tax holidays. To some extent, similar considerations swayed investors in Mexico.

C. Targeting FDI in the context of development strategies

40. The Meeting noted that, in the context of their industrialization strategies, many Governments used investor-targeting approaches, although they were not always necessarily identified as such. Successful targeting strategies required clarity concerning:

(a) Dissemination of information about the opportunities offered by the host country, i.e. successful country-image building;

(b) The industries, sectors and companies to be targeted and how to approach them;

(c) The compatibility of investors' needs with what a country had to offer.

41. Regarding the first point, data from investor countries such as Japan and the United States suggested that investment in Africa could be more profitable than in other regions. More could be done, therefore, to communicate such information more broadly to potential investors.

42. It was pointed out that investment decisions were ultimately taken not by companies but by individuals, and that it was they who ought to be targeted. Investor targeting required considerable persistence on the part of the investment promotion agency (IPA), namely contacting the same firm repeatedly before a decision on an investment project might be triggered. It was also observed that targeting had to be understood as an ongoing process, spanning the entire period from the first contact to the actual establishment of the firm and reaching into aftercare for existing investors. This had become a difficult exercise owing to the large number of IPAs and the competition among them, as well as to the greatly increased pool of TNCs from among which an IPA had to identify a subset of companies upon which to focus, as witnessed by the increasing number of small TNCs from many developing and transition countries. Last but not least, the demands of TNCs had become ever more sophisticated and difficult to comply with.

43. Since investor targeting constituted policy at the micro level, it was of paramount importance for an IPA to attend to details and to consult and involve various actors such as the pertinent government agencies, representatives of local service providers, consulting firms, and TNCs already operating in the host country, as well as experts in the firm(s)

targeted. It was equally important to convince stakeholders in the host economy, such as local manufacturers, that the inward FDI project would provide concrete benefits for them too. There was a case for being "aggressive and creative". The former required the involvement of senior political levels, perfect organization and strict confidentiality during negotiations, while "creativity" referred to using all conceivable vehicles of communication.

44. It was also noted that subnational and local offices within a country played a crucial role in targeting. They were the best and most accessible sources of information regarding emerging investment opportunities throughout the country. A coordinated approach by the promotion agencies at different levels was therefore highly advisable. Some experts emphasized the importance of analysing emerging world market opportunities as a precondition for efficient investor targeting. The case of Malaysia was cited: this country had seized the opportunity to develop a natural-rubber-based industry when the AIDS pandemic suddenly boosted world demand for latex products.

45. More broadly, the Meeting was briefed on the trade-data-based targeting tools developed by the International Trade Centre. The software facilitated a classification of export products, reflecting whether a country had won or lost market shares worldwide and the development of import demand for a particular good. Such classification could in turn serve to identify targetable product groups and industries and sectors. It addressed the first step in the two-step process for assessing countries' export competitiveness, namely an informed analysis of their export opportunities. A sound assessment of countries' capabilities constituted the second step.

46. Targeting typically consisted in attracting FDI into particular industries. For example, Malaysia was increasingly targeting specific high-skill services such as software development, education, medical services, and information technology and multimedia services, while Panama was targeting FDI into industries such as agro-processing and mining, as well as into services (e.g. packaging, education, health, information and communication technology services, tourism, financial services, telecommunications and logistics). Similarly, Ethiopia had, in cooperation with the United Nations Industrial Development Organization, launched a project to attract FDI into natural-resource-based manufacturing, such as textile, leather and footwear manufacturing, in partnerships with local companies.

47. In general, targeting by industry should focus on TNCs that:

(a) Were already established in the country, as they were easily approachable, and their reinvestments often accounted for a major share of FDI inflows;

(b) Were already part of a supply chain to which the country was linked;

(c) Were searching for countries' raw materials or for talents based in the host country; some countries were, for example, inviting highly qualified and talented people to take up residence as they might in turn attract FDI, or encouraging export- and FDI-oriented services such as software development, market research and call centres;

(d) Were operating in sectors where the country was competitive and had dynamic comparative advantages; and/or

(e) Could help to establish and develop new core competencies.

48. In addition to targeting by industry, some countries undertook geographical targeting by addressing specific investor home countries. The Uganda Investment Authority, for example, focused investment promotion activities on a number of regional countries (South Africa, Mauritius, Egypt and Kenya), countries with which Uganda shared particular interests (Netherlands, United Kingdom and United States) and, building on ethnic ties, other developing countries (India, China and Malaysia).

49. Targeting could also take the form of attracting investment to meet identified objectives, such as employment generation, domestic market development, generation of exports or upgrading of domestic industries. African countries, for example, noted that resource-seeking FDI might be used to begin processing of natural-resource-based products. This would require long-term policies initially aimed at enhancing their capabilities, notably the organization of commodity markets and the skills of the labour force.

50. The Meeting also considered targeting tools. Incentives, of whatever type, were seldom decisive factors in attracting FDI; rather, they would make a difference only where rival locations would provide a more or less identical offer. In all other cases, there was a risk that they would merely subsidize investment activities which companies would have undertaken in any event. On the other hand, it was noted that the use of incentives by developing countries was legitimate and appeared necessary for as long as developed countries continued to make ample use of them to attract FDI.

51. Financial support to potential investors, or conducting feasibility studies on their behalf, could be beneficial. Developing country IPAs could also utilize initiatives of investor home countries, such as outward investment promotion, as a vehicle for disseminating information about investment opportunities in their country.

52. Finally, it was important for IPAs to develop objective success and evaluation criteria and standards. A number of success indicators were mentioned, such as value-added created, the number or value of newly established projects, and employment criteria such as the number of jobs created directly, safeguarded, or created through multiplier effects.

53. In sum, although targeting was important since it could contribute to a focused and efficient use of an IPA's or a Government's limited resources, experts warned that there was no "one-size-fits-all" formula for investor targeting; instead, the approach depended *inter alia* on the country's stage of development, the specific overall priorities and the resources available. The need, therefore, to identify viable "niches" was emphasized.

D. Local entrepreneurship and development of supply capacity: Promoting backward linkages

54. The degree to which export-oriented industries and foreign-invested firms were embedded in the local economy is crucial with regard to enhancing the contribution of FDI to the industrialization of host countries. The Meeting therefore discussed various examples of policies on the development of local entrepreneurship and supply capacity, backward linkages and the clustering of firms.

55. As described in the *World Investment Report 2001*, backward linkages between foreign affiliates and local firms could benefit not only TNCs, but also host economies and local firms. Findings in that report illustrated the importance of linkage promotion, taking account of factors specific to industries, TNCs and host economies. Linkage promotion policies needed to be consistent with and embedded in a broad range of policies that facilitated enterprise development based on a clear vision of development strategy. Linkage promotion strategies were at the intersection of FDI promotion and SME development, serving the interests of both foreign investors and local SMEs.

56. Reviews of existing linkage programmes in medium- and high-income countries demonstrated the importance of Governments' efforts in the area of SME development. In several countries and subregions, they had provided assistance in the provision of information, matchmaking, technology upgrading, training and finance. Key steps towards an effective linkage promotion programme were set out in the *World Investment Report 2001*.

57. Low-income countries where financial resources were scarce (e.g. South Africa) could explore possibilities for the active involvement of the private sector to reduce the costs of establishing linkage programmes, and various forms of public-private partnerships. Most programmes reviewed in the *World Investment Report 2001* had been started on the initiative of the country's IPAs, relying on combined support from the public and private sectors. Indeed, IPAs could be a catalyst for linkage formation, provided that they had the necessary capacity and received assistance from all parties concerned.

58. With regard to supplier development, and with a view to maximizing the welfare derived from attracting export-oriented FDI, countries were well advised to develop domestic SMEs and/or to attract suitable foreign SMEs as potential suppliers. In respect of domestic SMEs, the recently launched PROVEE project in Costa Rica was of some significance, as it aimed at developing world-class local suppliers. One of the goals of supplier development was to enable efficient local firms to reach international standards and become exporters and outward investors in their own right, as illustrated by the case of a Costa Rican packaging manufacturer that had established subsidiaries in Mexico and the United States.

59. There was also a case for attracting foreign suppliers, and notably small or newly emerging TNCs, which unlike large TNCs often did not have the resources or capacities to study investment opportunities. Governments or IPAs could implement measures designed

specifically to attract and support such firms, which were often especially well suited to developing-country environments.

60. There were various examples of countries where a linkages development programme had made a difference. Malaysia, for example, had adopted a multiple approach, which included the setting up of trust funds to invest in SMEs, the attracting of foreign banks and insurance companies, the setting up of government-owned development banks and "moral pressure" by the Central Bank to convince commercial banks to include local SMEs in their lending portfolio. In Costa Rica, linkages creation was directed to activities such as training and certification for potential suppliers. In Uganda, the Uganda Investment Authority had a continuous private–public sector dialogue, and its staff had private-sector experience. With a view to developing subnational clusters to promote linkages, a cooperation project with the United States Agency for International Development (USAID) had been established to facilitate clustering.

61. A puzzling case was that of EPZs, which had generally been created expressly to attract FDI in export-oriented industries. They had often proved to be a constraint on the development of linkages. For example, in Malaysia, EPZ-specific incentives had restricted interaction between companies in the EPZ and the rest of the economy, with the result that it was decided to abolish the EPZ modality so as to better benefit from multiplier effects related to FDI. In China, the Special Economic Zones had successfully created a host of linkages with local firms, but the Government was now reconsidering the efficiency of local suppliers.

62. Certain industries such as electronics might not, a priori, lend themselves easily to the establishment of linkages. In such cases in particular, proactive government measures could facilitate their establishment, for example provision of information on existing suppliers and their capabilities or vendor development programmes; in addition, the Government could help upgrade industries. Furthermore, facilitating research and development centres, providing technical training material or influencing the prevailing mindset could have a favourable impact on linkages. In Malaysia, Intel had reportedly encouraged senior technical staff to set up their own enterprises and become suppliers. Although TNCs could contribute to supplier development, it was important that the Government play a proactive role, especially as regards the sharing of information about future demand.

63. Clusters of SMEs, often supported by public institutions, and of large domestic firms were another relevant modality which could empower developing countries to benefit from FDI and link it into the local economies. Moreover, clusters could be especially efficient in leveraging access to technology and to international markets. Government measures to facilitate the development of clusters of enterprises could therefore enhance the contribution of dynamic export-oriented FDI to the local economy. They called for a policy and strategy developed at the subnational level, where knowledge regarding local capacity and capability – "local platforms and local delivery" – was the most accurate and up to date.

64. Accordingly, an integrated approach to attract FDI in the targeted industries and to enhance the development of suppliers and linkages might well encompass cluster building. In

the case of the IPA for Wales, the Welsh Development Agency, this approach was adopted notably in order to attract and retain large investors such as Toyota, and the Agency was instrumental in setting up a Supplier Association comprising the TNC and local and foreign suppliers in the cluster.

65. Sweden and its "SOCware" programme, designed to build a cluster in the area of "Systems-on-Chips", provided another interesting example. The Swedish IPA had succeeded in attracting FDI into this sector by consulting all relevant players – companies, research institutes, and national as well as regional agencies. The consultation process, combined with feasibility studies, had served to identify potential shortcomings and pitfalls – in this case, a dearth of appropriately trained software engineers. In response, the Government, in coordination with other actors, had adopted specific policy measures for skills development.

66. Another example of a predominant role played by clusters of SMEs was in Italy. A significant portion of exports was generated by a group of numerous (non-diversified) SMEs which each served one or two foreign markets. These clusters had well-established linkages with each other and accounted for large shares of the country's exports, and they were high performers in the world market for a range of non-dynamic export goods (e.g. leather, tiles, jewellery, textiles and furniture). This suggested that export growth in the high-technology manufacturing sector was not necessarily the only indicator of a country's export competitiveness. Moreover, FDI inflows into Italy were relatively low, but were emerging in the non-dynamic export-oriented clusters.

67. In sum, the Meeting noted that clusters, drawing together local as well as foreign firms, were feasible and desirable as a means of promoting backward linkages. However, not all clusters would automatically be attractive to FDI and ensure that they were embedded in the local economy. The challenge was to build and mobilize local capacity corresponding to the needs of targeted foreign investors. In this respect, policies continued to play a crucial role in ensuring that the right conditions prevailed for attracting and benefiting from FDI in a manner that promoted growth and development.

Chapter III

ORGANIZATIONAL MATTERS

A. Convening of the Expert Meeting

68. The Expert Meeting on the Impact of FDI Policies on Industrialization, Local Entrepreneurship and the Development of Supply Capacity was held at the Palais des Nations, Geneva, from 5 to 7 November 2001.

B. Election of officers

(Agenda item 1)

69. At its opening meeting, the Expert Meeting elected the following officers to serve on its bureau:

Chairperson: Ms. Maggie Kigosi (Uganda)

Vice-Chairperson-cum-Rapporteur: Mr. Lelio Iapadre (Italy)

C. Adoption of the agenda and organization of work

(Agenda item 2)

70. At the same meeting, the Expert Meeting adopted the provisional agenda circulated in document TD/B/COM.2/EM.10/1. The agenda for the Meeting was thus as follows:

1. Election of officers.
2. Adoption of the agenda and organization of work.
3. The impact of FDI policies on industrialization, local entrepreneurship and the development of supply capacity of developing countries, in particular the least developed countries.
4. Adoption of the outcome of the Meeting.

D. Documentation

71. For its consideration of the substantive agenda item, the Expert Meeting had before it a note by the UNCTAD secretariat entitled "The impact of FDI policies on industrialization, local entrepreneurship and the development of supply capacity: Policy issues to consider" (TD/B/COM.2/EM.10/2).

E. Adoption of the outcome of the Meeting

(Agenda item 4)

72. At its closing meeting, the Expert Meeting authorized the Rapporteur to prepare the final report of the Meeting under the authority of the Chairperson.

Annex

ATTENDANCE *

1. Experts from the following States members of UNCTAD attended the Meeting:

Angola
Bangladesh
Belarus
Belgium
Benin
Burkina Faso
Burundi
Cambodia
Cameroon
China
Colombia
Congo
Costa Rica
Côte d'Ivoire
Czech Republic
Democratic People's Republic of Korea
Democratic Republic of the Congo
Dominican Republic
Ecuador
Egypt
Ethiopia
Finland
France
Guinea-Bissau
Honduras
Indonesia
Italy
Japan
Kenya
Lebanon
Madagascar
Mexico
Morocco
Nepal
Niger
Nigeria
Pakistan
Panama
Peru
Philippines
Russian Federation
Rwanda
Saint Kitts and Nevis
Saudi Arabia
Swaziland
Sweden
Syrian Arab Republic
Thailand
Togo
Tunisia
Uganda
United Republic of Tanzania
United States of America
Venezuela
Viet Nam
Yemen
Zambia

* For the list of participants, see TD/B/COM.2/EM.10/INF.1.

2. The following intergovernmental organizations were represented at the Meeting:

Arab Labour Organization
Organisation for Economic Co-operation and Development
Organization of the Islamic Conference

3. The following specialized agencies and related organization were represented at the Meeting:

International Labour Organization
International Monetary Fund
International Telecommunication Union
United Nations Industrial Development Organization
World Trade Organization

4. The United Nations Development Programme was represented at the Meeting.

5. The following non-governmental organizations were represented at the Meeting:

General Category

Exchange and Cooperation Centre for Latin America
International Federation of Business and Professional Women
Organization of African Trade Union Unity

6. The following panellists attended the Meeting:

Mr. Enrique J. Egloff, President, Cradvisory.com, Costa Rica
Mr. Carlos Garcia Fernandez, Director-General, Foreign Investment, Ministry for the Economy, Mexico
Mr. J. Jegathesan, Former Deputy Director, MIDA, Malaysia
Mr. John A. Mathews, Professor, Macquarie Graduate School of Management, Macquarie University, Australia
Ms. Olga Memedovic, Industrial Policies and Research Branch, UNIDO
Mr. Jean-Michel Pasteels, Market Analyst, International Trade Centre, Geneva
Mr. Richard Pfaffstaller, Vice President, Strategic Infrastructure Development, Flextronics Central Europe, Austria
Mr. Clive Vokes, Clive Vokes Associates, United Kingdom

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Conference
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4 December 2001

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TRADE AND DEVELOPMENT BOARD
Commission on Investment, Technology,
and Related Financial Issues
Sixth session
Geneva, 21-25 January 2002
Item 2 of the provisional agenda

PROVISIONAL AGENDA AND ANNOTATIONS

I. PROVISIONAL AGENDA

1. Election of officers

2. Adoption of the agenda and organization of work

3. Impact of international investment flows on development: The impact of FDI policies on industrialization, local entrepreneurship and the development of supply capacity of developing countries, in particular the least developed countries

4. International policy issues: International arrangements for transfer of technology: Best practices for access to and measures to encourage transfer of technology with a view to capacity building in developing countries, especially in least developed countries

5. Investment policy reviews: exchange of national experience

6. Reports of the subsidiary bodies of the Commission

GE.01-53399 LS

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7. Progress report on the implementation of agreed conclusions and recommendations of the Commission

8. Provisional agenda for the seventh session of the Commission

9. Other business

10. Adoption of the report

II. ANNOTATIONS TO THE PROVISIONAL AGENDA

Introduction

1. The Conference, at its tenth session, held from 12 to 19 February 2000 in Bangkok (Thailand), in considering the issue of UNCTAD's intergovernmental machinery, welcomed the document prepared by the UNCTAD secretariat entitled "Improving the functioning and the structure of the intergovernmental machinery of UNCTAD" (reissued in TD/B/EX(24)/L.1). The purpose behind the recommendations contained in that document was *inter alia* to enhance the status of the Commissions as policy-formulating organs and to strengthen the substantive linkages between expert meetings and Commissions. It was recommended that the Commissions' work should be informed by the technical advice of the experts, that the Commissions should place the results of expert meetings within the appropriate policy context and framework, and that, on the basis of the expert reports and their own policy dialogue, the Commissions should make recommendations on actions to be taken by member States, UNCTAD or other bodies.

2. To this end, the Commission will have before it the reports of the expert meetings held during the previous months, as well as documentation prepared by the secretariat identifying, and commenting on, the policy questions posed by the expert reports for discussion by the Commission. In this connection, the outcomes of the expert meetings were circulated by the secretariat to member States with a request for policy comments on the experts' recommendations. The task of the Commission is to conduct policy dialogue and make policy recommendations on the outcome of the expert meetings, taking into account the views from the capitals.

Item 1 Election of officers

3. In accordance with rule 18 of the rules of procedure of the main Commissions of the Trade and Development Board, the Commission shall elect a Chairperson, five Vice-Chairpersons and a Rapporteur from among the representatives of its members, taking into account the need to ensure equitable geographical distribution. Moreover, rule 19 of the rules of procedure states that the Bureau of the Commission shall consist of seven members (i.e. four members from Lists A and C combined, two members from List B and one member from List D, referred to in the annex to General Assembly resolution 1995 (XIX) as amended).

4. Accordingly, following the cycle of rotation established after UNCTAD IX, the bureau for the sixth session of the Commission will be as follows: Chairperson from List A (Asia); Rapporteur from List B; and five Vice-Chairpersons (3 from lists A and C combined, 1 from List B and 1 from List D).

Item 2 Adoption of the agenda and organization of work

5. The sixth session of the Commission is scheduled for 21-25 January 2002. The Commission on Investment, Technology and Related Financial Issues approved the agenda items for this session and the related Expert Meetings at its fifth session (12-16 February 2001).

6. With regard to the organization of the work of the session, the Commission has five days available to it. It is suggested that the agenda items be taken up sequentially, with the first plenary meeting, on Monday, 21 January, being devoted to procedural matters and introductory statements.

7. The secretariat will prepare a detailed programme, which will be available on the first day of the session.

Documentation

TD/B/COM.2/36 Provisional agenda and annotations

Item 3 *Impact of international investment flows on development: The impact of FDI policies on industrialization, local entrepreneurship and the development of supply capacity of developing countries, in particular the least developed countries*

8. The experiences of many newly industrializing countries have shown that trade and growth are closely associated, and a sustainable industrialization strategy is supported by these countries' capacity to export and to expand their competitive advantage, moving up the value-chain of production. In many of these countries, FDI has played an important role in

the development of export-oriented industries. It has to be noted that the role of policies is crucial, not only in attracting the kind of FDI which helps to develop industries that correspond to and utilize the dynamic comparative advantage of host countries, but also to ensure that the potential benefits from FDI are spread to domestic enterprises through linkages between foreign affiliates and local suppliers. The question here is what policy lessons can be drawn from these experiences, and how can countries at different stages of development design FDI policies suitable to their particular context? In a globalizing world, TNCs are playing a determining role in the flows and directions of trade, reflecting their decisions as to whether or not to internalize their production along the value chain and where to locate their production activities. A central question here is, how can developing countries – by attracting the right type of FDI – best tap into the international production systems of TNCs? It is important when designing FDI policies to understand TNCs' corporate strategies in order to reconcile TNCs' motives with host countries' development priorities.

9. Discussion under item 3 is expected to focus on issues relevant to the impact of FDI policies, as stressed above, namely: the link between foreign direct investment and industrialization, export competitiveness and development of supply capacity; FDI promotion in the context of development strategies; specific instruments and tools for FDI targeting; and the promotion of backward linkages to support local entrepreneurship and development of supply capacity.

10. To facilitate the deliberation, the Commission will have before it: (i) the issues note prepared for the Expert Meeting on the Impact of FDI Policies on Industrialization, Local Entrepreneurship and the Development of Supply Capacity of Developing Countries, in particular in the Least Developed Countries; (ii) the final report of the Expert Meeting; (iii)

the Overview of the *World Investment Report 2002* (Promoting Linkages); (iv) a note by the UNCTAD secretariat on the outcome of the Expert Meeting.

Documentation

UNCTAD/WIR/2001	*World Investment Report 2001*, Promoting Linkages (Overview)
TD/B/COM.2/EM.10/2	The Impact of FDI Policies on Industrialization, Local Entrepreneurship and the Development of Supply Capacity, Policy Issues to consider, Note by the UNCTAD secretariat
TD/B/COM.2/35 TD/B/COM.2/EM.10/3	Report of the Expert meeting on the Impact of FDI Policies
TD/B/COM.2/38	Note by the UNCTAD secretariat

Item 4 *International policy issues: International arrangements for transfer of technology: Best practices for access to and measures to encourage transfer of technology with a view to capacity building in developing countries, especially in least developed countries*

11. The need for technology transfer, especially to developing countries, has been recognized in various international fora. Over 80 international instruments and numerous subregional and bilateral agreements contain measures related to transfer of technology and capacity building. The technology-related provisions contained in such instruments follow different approaches, depending on the object and purpose of these respective instruments. They all aim, however, at promoting access to technologies and, in some cases, the development of local capabilities in developing countries, particularly in least developed countries.

12. The Bangkok Plan of Action requested UNCTAD, *inter alia*, to analyse all aspects of existing international agreements relevant to transfer of technology (Plan of Action (TD/390), paragraph 117) and examine and disseminate widely information on best practices for access to technology and (Plan of Action, paragraph 128). Discussion of this item is expected to focus on the policy implications of the outcome of the Expert Meeting (TD/B/COM.2/33), which will be presented by its Chairperson. The Expert Meeting identified a number of best practices that could contribute to generating favourable conditions and opportunities for transfer of technology and capacity building, and the Commission may wish to consider how these practices could be more widely encouraged within the overall context of international instruments.

13. To facilitate the deliberations, the Commission will have before it (i) a note by the UNCTAD secretariat on the outcome of the Expert Meeting; (ii) the issues note for the Expert Meeting; (iii) the report of the Expert Meeting.

Documentation

TD/B/COM.2/37 International arrangements for transfer of technology: Note by the UNCTAD secretariat

TD/B/COM.2/EM.9/2 International arrangements for transfer of technology: Issues note by the UNCTAD secretariat

TD/B/COM.2/33 Report of the Expert Meeting on International Arrangements for
TD/B/COM.2/EM.9/3 Transfer of Technology: Best Practices for Access to and Measures to Encourage Transfer of Technology with a view to Capacity-Building in Developing Countries, Especially in Least Developed Countries.

Item 5 Investment policy reviews: exchange of national experience

14. Investment policy reviews are intended to assist countries in improving their investment policies with a view to attracting foreign direct investment and benefiting more from it. The policy reviews are undertaken upon request of member States. The Commission on Investment, Technology and Related Financial Issues takes up the policy reviews at the intergovernmental level in order to promote the exchange of national experiences and, in particular, to familiarize Governments and investors with these countries' investment environment.

15. The Commission will have before it the Investment Policy Review of the United Republic of Tanzania. The secretariat and a high-level representative will introduce the country report, followed by deliberations of the review panel and a general discussion.

16. Item 5 will also provide an opportunity to review follow-up to the recommendations contained in previously conducted policy reviews. At its last session, the Commission considered four policy reviews (Ethiopia, Ecuador, Mauritius and Peru).

Documentation

UNCTAD/ITE/IPC/Misc.9	Investment Policy Review of the United Republic of Tanzania

Item 6 *Reports of the subsidiary bodies of the Commission*

17. Under this item, the Commission will consider the report of the eighteenth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) and the report of the third session of the Intergovernmental Group of Experts on Competition Law and Policy. The reports of the two subsidiary bodies will be available for consideration by the Commission.

Documentation

TD/B/COM.2/34 TD/B/COM.2/ISAR/13	Report of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting on its eighteenth session
TD/B/COM.2/32 TD/B/COM.2/CLP/24	Report of the Intergovernmental Group of Experts on Competition Law and Policy on its third session

Item 7 *Progress report on the implementation of agreed conclusions and recommendations of the Commission*

18. The note on "Improving the functioning and the structure of the intergovernmental machinery of UNCTAD" (TD/B/EX(24)/L.1), re-endorsed by the Board at its twenty-sixth executive session on 10 April 2001, states: "Starting with the second session of each Commission, the fifth day of the session will be used for policy reviews of implementation by member States and the secretariat of the outcome of previous sessions, on the basis of documentation produced by the secretariat."

19. With regard to the implementation of the outcome of the fifth session of the Commission by the secretariat, the secretariat will provide the Commission with a report on its activities in that connection. Concerning implementation by member States, those member States wishing to do so will have an opportunity to present their experience to the Commission.

20. The attention of the Commission is also drawn to the decision adopted by the Trade and Development Board at its twenty-fourth executive session on 12 May 2000 by which the Trade and Development Board decided *inter alia* to "conduct in the second quarter of the year 2002 a mid-term review of the work of UNCTAD, based on the indicators of achievement agreed to in the medium-term plan (2002-2005)". The Commission's attention is drawn in particular to indicator (b) from the Medium-term Plan 2002-2005, which comprises "Member States' views on the practical value and impact on the development prospects of developing countries of policy recommendations, as expressed in the conclusions of the regular review of the work undertaken by intergovernmental bodies". The views and conclusions of the Commission under this topic will therefore serve as inputs to the mid-term review.

Documentation

TD/B/COM.2/39 Progress report on the implementation of agreed conclusions and recommendations of the Commission

Item 8 Provisional agenda for the seventh session of the Commission

21. A draft provisional agenda for the seventh session of the Commission will be submitted for consideration and approval.

Item 9 Other business

22. Under this item, the Division on Investment, Technology and Enterprise Development will make a presentation on its activities, covering the period between the fifth and sixth sessions of the Commission. The Commission will have before it an update on the previously produced DITE activities report (reporting end February 2001).

23. Representatives of other international organizations are invited to report briefly on their activities. The President of WAIPA will report on WAIPA's Seventh Annual Conference, which is held in parallel to the Commission.

24. To inform the Commission about the ongoing work of the Commission on Science and Technology for Development (CSTD), a briefing will be organized to highlight activities carried out within the framework of that Commission, including the results of its work on

biotechnology and its plans for developing its new substantive theme of technology development and capacity-building for competitiveness in a digital economy.

Item 10 Adoption of the report

25. The report of the Commission will be adopted at its final plenary meeting and submitted to the Trade and Development Board for consideration.

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TRADE AND DEVELOPMENT BOARD
Commission on Investment, Technology and Related Financial Issues
Geneva, 21-25 January 2002
Item 4 of the provisional agenda

INTERNATIONAL ARRANGEMENTS FOR TRANSFER OF TECHNOLOGY

Note by the secretariat

CONTENTS

I. Main focus of discussions
II. Summary of Outcome
III. Comments by UNCTAD member States on the experts' recommendations

1. The Expert Meeting on International Arrangements for Transfer of Technology was held in Geneva from 27 to 29 June 2001. It was aimed at identifying the best practices for access to and measures to encourage transfer of technology with a view to capacity-building in developing countries, especially in least developed countries.

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I. Main focus of discussions

2. The discussions were focused on analysing the implementation of several dozen international instruments that include provisions for enhancing the transfer of technology to developing countries, particularly least developed countries (LDCs), as well as their technological capacities. It was noted that implementation issues need further discussions. This is in line with paragraph 117 of the Bangkok Plan of Action (TD/386), which calls upon UNCTAD to "analyse all aspects of existing international agreements relevant to transfer of technology", and paragraph 128, which states that "In the area of transfer of technology, UNCTAD should examine and disseminate widely information on the practices for access to technology".

II. Summary of Outcome

3. The Outcome of the meeting (document TD/B/COM.2/EM.9/L.1) notes that more needs to be done to successfully implement international instruments, including with respect to enhancing the transfer of technology to developing countries, in particular to the LDCs, as well as their technological capabilities.

4. The Outcome contains a list of best practices that could contribute to generating favourable conditions and opportunities for transfer of technology and capacity-building. These include:

- International instruments with built-in implementation mechanisms, including financial provisions and monitoring arrangements; these have a promising implementation record in the area of environmental protection and should be emulated. They could serve as a model in other areas such as infrastructure, health, nutrition and telecommunications;

- Making the Agreements on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement) more conducive to transfer of technology, in accordance with its Articles 7, 8 and 40, including by reviewing its impact on transfer of technology and capacity-building;

- Establishing a special trust fund, based on successful models, to promote research and development (R&D) in developing countries and other activities in the area of technology with a view to assisting developing countries in benefiting from their various international commitments;

- Designing measures and specific incentives for home-country enterprises, including fiscal and other incentives, to promote transfer of technology, especially through foreign direct investment (FDI) in developing countries. In this connection, the monitoring of implementation of the commitments in Article 66.2 of the TRIPS Agreement could contribute to building a sound and viable technological base in LDCs;

- Creating a hospitable domestic regulatory environment for foreign investment, together with intellectual property protection, improves access to technology. It has been observed that the transfer of technology is often most successful when effected by means of investment, especially FDI.

5. For those purposes, the experts proposed that UNCTAD should:

- Provide assistance to developing countries, particularly LDCs, in strengthening their capacity to discuss and to negotiate technology transfer provisions in international instruments;

- Further explore ways and means for effective implementation of international commitments in the area of transfer of technology and capacity-building;

- Compile an illustrative list of home-country measures that might fulfil the requirements of Article 66.2 of the TRIPS Agreement;

- Assist interested countries by undertaking a needs assessment with regard to the interface between commitments in the TRIPS Agreement and national implementation requirements with a view to adjusting the TRIPS standards to local innovation needs and to fostering their pro-competitive implementation.

6. As requested, UNCTAD member States provided their policy comments on the Outcome. These are summarized below for consideration by the Commissions

III. Comments by UNCTAD member States* on the experts' recommendations

7. Comments by UNCTAD member States focused on the following areas:

Elements of the Outcome that would require follow-up actions

a. International instruments with built-in implementation mechanisms, including financial provisions and monitoring arrangements

8. Wide dissemination of this type of instrument is needed, as well as further surveys on their performance, in order to extend them to areas other than environmental protection. Models relevant in this connection include the Montreal Protocol, which includes provision for environment-related transfer of technology, and the Convention on Biological Diversity (CBD), which contains a mechanism for financing transfer of technology to the developing countries.

b. Ensuring access, in particular that of developing countries, to technological information on a competitive basis

9. Implementation of feasible and useful mechanisms is required in order to ensure access to technological information on fair and equitable terms and conditions. Such information should be available in various languages and should be disseminated, especially in rural areas, together with successful country examples, with the aim of popularizing available technologies through exhibitions, seminars and workshops.

c. Taking measures to prevent anti-competitive practices by technology rights holders or practices that unduly impede the transfer and dissemination of technology

10. Compilation of a list of anti-competitive practices and their effects, as well as existing legislation aimed at preventing such practices, is necessary in order to develop relevant legislation for developing countries.

d. Making the TRIPS Agreement more conducive to transfer of technology

11. Implementing ways of disseminating the benefits of the Agreement in the developing countries is required, as well as designing projects for evaluating all aspects of the transfer of technology.

e. Setting up interministerial coordination committees at the national/regional level concerning the interface between commitments in the TRIPS Agreement and national implementation requirements

12. The establishment of these committees is needed in order to adjust TRIPS standards to local innovation needs and harmonize the TRIPS Agreement with other international legal instruments related to biodiversity such as the CBD and the Food and Agriculture Organization's Undertaking on Plant Genetic Resources.

f. Establishing a special trust fund to promote R&D in developing countries and other activities in the area of technology

13. Establishment of a trust fund on the basis of successful models is welcome. Such a fund should constitute a suitable option for developing countries, in particular LDCs. Its feasibility needs to be evaluated in depth, taking into account the restrictions faced by the developing countries. Other concerns of developing countries relate to financing transfer of technology.

g. Supporting capacity-building, particularly in the LDCs

14. The establishment of specific projects and programmes for supporting capacity-building is recommended, in particular in the areas of human resources, institutional capacities for R&D and assessment of technology needs. Such projects and programmes should help to create a science and technology infrastructure on a cooperative basis.

h. Creating a hospitable domestic regulatory environment for foreign investment and transfer of technology

15. Mechanisms for creating a hospitable domestic regulatory environment for FDI and transfer of technology should be complemented with international technical cooperation and with scientific and technology development programmes in developing countries. UNCTAD would contribute by providing a forum for discussing and exchanging experiences with a view to enhancing technical cooperation and establishing national regulatory frameworks favourable to FDI.

Proposals on a Work Programme to implement the recommendations

a. Designing measures and specific incentives for home-country enterprises to promote transfer of technology in the developing countries

16. It is proposed that an illustrative list of home-country measures and specific incentives for enterprises be compiled and disseminated. Their aim would be to promote transfer of technology that would fulfil the requirements of Article 66.2 of the TRIPS Agreement with a view to their inclusion in future commitments aimed at enhancing the technology base in the developing countries. Public institutions have an important role to play in encouraging the activities of the private sector in the field of technology.

b. Strengthening developing countries' capacity for discussing and for negotiating technology transfer provisions in international instruments

17. Developing countries, particularly LDCs, should be assisted in strengthening their capacity to discuss and negotiate technology transfer provisions.

Specific technical assistance programmes arising from the Outcome

18. It was proposed that:

(a) Financial assistance be provided to developing countries, especially LDCs, for bearing the costs of reforming their administrative and legal frameworks in order to apply international intellectual property standards and comply with the commitments under the TRIPS Agreement;

(b) Assistance be provided for designing specific arrangements to support transfer of technology, including linkages between R&D institutions and productive sectors;

(c) Forums be orgainzed for discussing specific arrangements concerning implementation of international commitments, including provisions for protection of intellectual property rights and transfer of technology;

(d) Assistance be provided for carrying out a needs assessment of transfer of technology, particularly in LDCs, including identification of the barriers to transfer of technology, and that seminars/workshops on legal issues be organized at the national and regional levels.

19. Considering the emphasis placed by the experts on international arrangements for transfer of technology, the Commission on Investment, Technology and Related Financial Issues may wish to consider, at its sixth session, the Outcome of the Expert Meeting, taking into account best practices that can contribute to creating conditions and opportunities for transfer of technology and capacity-building. It may also wish to consider the availability of information about such arrangements and best practices required for sustained multilateral cooperation, and its dissemination in various United Nations Languages.

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Sixth session
Geneva, 21-25 January 2002
Item 3 of the provisional agenda

IMPACT OF INTERNATIONAL INVESTMENT FLOWS ON DEVELOPMENT: THE IMPACT OF FDI POLICIES ON INDUSTRIALIZATION, LOCAL ENTREPRENEURSHIP AND THE DEVELOPMENT OF SUPPLY CAPACITY OF DEVELOPING COUNTRIES, IN PARTICULAR THE LEAST DEVELOPED COUNTRIES

Note by the UNCTAD secretariat

CONTENTS

Chapter		Page
	Introduction	2
I.	Policy considerations: The role of Governments	3
II.	Policy considerations: The role of the international community	8
III.	Proposals for future work	9

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INTRODUCTION

1. In line with the decision by the Trade and Development Board at its twenty-fourth executive session on 24 March 2000, the secretariat has prepared this note on the policy considerations raised by experts at the Expert Meeting on the Impact of FDI Policies on Industrialization, Local Entrepreneurship and the Development of Supply Capacity, as set out in its Outcome.[1] The purpose of this note is to identify and comment on the policy questions posed by the experts for consideration by the Commission on Investment, Technology and Related Financial Issues at its sixth session.

2. The Outcome of the Expert Meeting was sent to member States for comments. No comments have been received, perhaps because, owing to the date of the Expert Meeting, very little time was given to member States to reply. This note therefore draws on the views of the experts as reflected in the Chairperson's summary of the discussions at the Expert Meeting, as well as on the analysis in the *World Investment Report 2001: Promoting Linkages*. The policy considerations of the Outcome of the Expert Meeting, which were identified by experts as being the most pertinent, are reproduced in full (text in italics), followed by comments and observations. The last section of the note presents proposals on future work that were put forward during the Expert Meeting.

[1] "The impact of FDI policies on industrialization, local entrepreneurship and the development of supply capacity of developing countries, in particular the least developed countries", TD/B/COM.2/EM.10/L.1.

Chapter I

POLICY CONSIDERATIONS: THE ROLE OF GOVERNMENTS

3. *Governments are encouraged to consider cost-efficient ways of promoting foreign direct investment (FDI) policies that are consistent with their country's overall development objectives and industrialization strategies, fully involving the private sector and reconciling foreign investors' motives with the country's priorities. While government leadership in providing a clear vision of a development strategy is the starting point, a public–private sector partnership is both helpful and necessary during the implementation stages.* (para. 12).

4. A growing number of countries recognize that an inflow of FDI can bring important benefits to the host country. However, it is also noted that such benefits cannot be taken for granted. The policy challenge for countries is two fold: (a) to attract the kind of investment that can add to the competitiveness of the host country's economy and production capacity; and (b) to realize the potential benefits from the inward FDI that takes place. In both cases, a clear development strategy is important in order to identify in what sectors and for what activities FDI would be most desired. Similarly, close cooperation with the private sector is required in order to enhance the understanding of corporate strategies, to identify investment opportunities and to promote beneficial impacts deriving from inward FDI. A thorough understanding of international production systems and strategies of transnational corporations (TNCs) can usefully contribute to successful implementation of industrialization and export strategies using FDI as a catalyst.

5. *Coordination among government agencies and departments, and a simplified institutional setting consisting of a lead agency for FDI promotion, are also highly recommended.* (para. 13).

6. The process of selecting locations for investment involves consideration of a large number of aspects. Typically, there is a need for cooperation among the various government institutions that play a role in providing, for example, information, licences and incentives in this process. Many countries have found it useful to appoint a single agency, either as a part of a ministry or more independently, to be responsible for the coordination of investment promotion activities. To become an efficient "one-stop-shop", investment promotion agencies need a well-functioning network both with other government actors and with those in other sectors. Such a network benefits from a strong political commitment as well as from close interaction with both domestic and foreign-owned companies in the private sector.

7. *A targeted approach is recommended in designing FDI promotion policies, as it represents the most efficient use of limited resources, offers the best prospects for success, and helps to achieve strategic goals.* (para. 14).

8. The strategies to attract FDI are evolving. In the *first generation* of investment promotion policies, countries simply liberalize their enabling frameworks for FDI to attract more investment. This continues to happen throughout the world. UNCTAD data show that in 2000 alone out of some 150 FDI regulatory changes made by 69 countries, 98 per cent

were in the direction of creating a more favourable environment for FDI. While such (in a sense passive) liberalization is important for attracting much-desired investment, it is usually not sufficient in the increasingly competitive world market for FDI. Consequently, in the *second generation* of investment promotion policies, countries actively "market" their countries as locations for FDI. This approach, which typically includes the setting up of national investment promotion agencies, has been widely adopted by developed as well as developing countries. For example, the World Association of Investment Promotion Agencies, created as recently ago as 1995, today has more than 110 members. The *third generation* of investment promotion policies adopts an enabling framework for FDI and a proactive approach towards attracting FDI as a starting point. It then proceeds to target foreign investors (in accordance with a country's developmental priorities) at the level of industries and firms and seeks to meet their specific locational needs. Although a targeted approach is difficult and takes time to develop, third-generation promotion is increasing.

9. A targeted approach is not only becoming more important for facing the growing competition in the area of investment promotion, but is also desirable from the point of view of achieving efficient use of scarce resources. Targeting may also help policy makers to improve their understanding of corporate strategies and of the specific locational assets and liabilities that are associated with their host countries. An "honest" assessment of the ability to meet the requirements of specific investors is important with regard to deciding on what activities and firms to target. There is no "one-size-fits-all" formula to apply. Instead, the approach has to take the specific circumstances of each country into account. Targeting is an ongoing process and needs to be adapted to, and to develop with, the evolving objectives (employment generation, promotion of competition, generation of exports, technology inflow or upgrading of the domestic enterprise sector) and locational capabilities of countries.

10. *To increase the beneficial leverage of FDI on the host economy, Governments need to pay special attention to developing local supplier programmes, and to upgrading the technology and capacity of local suppliers.* (para. 15).

11. Linkages with local firms and institutions constitute the best channel for diffusing skills, knowledge and technology from foreign affiliates to host economies. Such linkages can contribute to the growth of a vibrant domestic enterprise sector, which is the bedrock of economic development, and thereby to a country's supply capacity. For developing countries, the formation of backward linkages, whereby foreign affiliates purchase parts, components or services through various forms of outsourcing or subcontracting arrangements, is of particular importance.

12. Firms too have an interest in fostering linkages. Supply chain management has become critical for the competitiveness of many TNCs. For example, a manufacturing firm spends on average more than half its revenues on purchased inputs. In response, some TNCs organize special development programmes in host developing countries to assist potential or existing suppliers. The experience of various companies illustrates how companies in different industries and host countries can actively support suppliers in upgrading their technology, productivity and ability to compete internationally. However, the extent to which foreign affiliates create linkages with domestic suppliers (as opposed to, say, using imports)

is determined by the cost–benefit ratio of such efforts, as well as by differences in firm-level perceptions and strategies. The most important factors are related to corporate strategy and the availability of supply capacity. A lack of efficient domestic suppliers is a common obstacle to the creation of linkages, particularly in developing countries. Building on the basic self-interest of firms as regards backward linkages, policy makers in host countries have an important role to play in influencing the willingness of foreign affiliates to use local suppliers. In particular, they can address specific obstacles to the linkage formation process by increasing the benefits and/or reducing the costs of using domestic suppliers. For example, TNCs may be unaware of the availability of viable suppliers, or they may find it just too costly to use them as sources of inputs.

13. *Governments should examine the key elements of a linkage promotion programme, as summarized in the following steps: (a) setting the policy objectives, in line with the country's overall development strategy; (b) identifying the targets of the programme: selection of industries, foreign affiliates and domestic firms; (c) identifying the specific measures to be adopted, in terms of information and matchmaking, technology and technical assistance, training and provision of finance; and (d) setting up an institutional and administrative framework to implement and monitor the programme.* (para. 16).

14. As described in more detail in the *World Investment Report 2001*, linkage promotion policies need to be consistent with and embedded in a broad range of policies that support enterprise development and FDI promotion. Some countries – Costa Rica, the Czech Republic, Ireland, Malaysia, Singapore and the United Kingdom, for example – have, often with considerable success, set up comprehensive linkage development programmes involving a combination of different policy measures and targeting selected industries and firms. Well-targeted government support can tilt the balance in favour of more linkages and thereby contribute to transfers of knowledge from TNCs that can foster the development of a vibrant domestic enterprise sector. Of course, like other development policies, linkage promotion efforts need to be adapted to the circumstances prevailing in each host country and should be undertaken in close collaboration with the private sector and other stakeholders.

15. The starting point for an effective linkage programme is a clear vision of how FDI fits into the overall development strategy and, more specifically, a strategy to build production capacity. The vision has to be based on a clear understanding of the strengths and weaknesses of the economy and of the challenges facing it in a globalizing world. A linkage programme should in particular address the competitive needs of domestic enterprises and the implications these have for policies, private and public support institutions, and support measures (including skills and technology upgrading). It is advisable for policy makers that choose this approach to "start small" (perhaps with a pilot scheme) and to build policy monitoring, flexibility and learning into the programme. The need to start small is all the greater when resources are scarce. Moreover, it is essential for any programme to seek close collaboration with the private sector – both foreign affiliates and domestic suppliers – in design and implementation.

16. When designing a linkage promotion programme, Governments need to be aware of actions already taken by foreign affiliates and domestic firms. Some of these may need to be

encouraged and supported. Governments can act as facilitators and catalysts and ensure that private institutions have the incentives and resources needed. They can be particularly pro-active in the following key areas of linkage formation: information and matchmaking; technology upgrading; training; and access to finance. The range of measures that can be taken in each of these areas is wide. Their principal purpose is to encourage and support foreign affiliates and domestic firms in creating and deepening linkages. Specific choices depend on the results of earlier consultations with existing support institutions and relevant programmes in the public and private sectors, as well as with key stakeholders on the specific needs of an industry or set of firms. Governments could also encourage participating foreign affiliates to agree to a coaching and mentoring arrangement with promising local firms.

17. Linkage programmes can only work if they are networking effectively with efficient intermediate institutions providing support in skill building, technology development, logistics and finance. These include standards and metrology institutes, testing laboratories, research and development centres and other technical extension services, productivity and manager training centres, and financial institutions. They can be public or private. It is also important that linkage programmes work closely with relevant private associations – chambers of commerce and industry, manufacturers' associations, investors' associations and so on. Trade unions and various interest groups are other important stakeholders. Finally, it is important to have a monitoring system in place to evaluate the success of a programme. Often, in a learning-by-doing process, a programme needs to be adjusted and refined as experiences accumulate and situations change. The system could include benchmarks and surveys of users.

18. *Home countries should share experiences in targeting and linkage promotion, and assist in this respect. Improved access to developed country markets, especially for products from the least developed countries and low-income countries, can help those countries to attract FDI. Home countries are also encouraged to provide financial assistance to developing countries, particularly those with limited resources, for the establishment of an appropriate framework for FDI promotion and linkage development. Outward FDI agencies in developed countries could serve as vehicles for supporting FDI in developing countries, for example by liaising with investment promotion agencies in those countries and disseminating information.* (paras. 18-21).

19. Targeting, like linkage promotion, involves relatively sophisticated policies. It requires considerable human and financial resources. Some efforts by developing countries to attract and benefit from FDI are hampered by trade and other barriers related to economic exchange with the developed countries' markets. Against this background, Governments in the home countries of TNCs can play an important role in providing technical assistance in the area of investment promotion as well as linkage development. There is a need to improve the dissemination of information on existing investment opportunities in developing countries, particularly in the least developed countries. Outward investment promotion agencies may contribute by sharing such information with potential investors in their countries. Moreover, by opening their markets further, developing countries increase their chances of attracting export-oriented FDI. Experience has shown that developing countries or

economies in transition benefiting from preferential access to major markets have attracted substantial amounts of FDI, and sometimes, when capable local suppliers are available, rules of origin can help foster linkages.

Chapter II

POLICY CONSIDERATIONS: THE ROLE OF THE INTERNATIONAL COMMUNITY

20. *International institutions dealing with FDI should assist developing countries and countries in transition in setting up an appropriate institutional framework for FDI policies and targeting, including the formation of clusters. Cooperation and coordination among United Nations agencies and other relevant institutions on these issues are desirable. The international community should assist the least developed countries in building and improving the infrastructure necessary for attracting FDI.* (paras. 22-24).

21. Measures by individual Governments can be complemented by efforts by the international community. Examples of such efforts include the provision of training in the area of investment promotion and linkage promotion, analysis of the framework for international investment, and assistance in implementing policy measures that would enhance the competitiveness of developing countries as locations for FDI and/or would help developing countries to benefit more from inward FDI. The international community, including both the public and the private sectors, can also assist in terms of disseminating information on investment opportunities in developing countries. Special attention needs to be paid to the situation of the least developed countries in this regard.

Chapter III

PROPOSALS FOR FUTURE WORK

22. *UNCTAD should: (a) continue to analyse the international systems of production, by sector and industry, and make this information available to member countries; (b) assist developing countries in assessing their existing capabilities in order to help them define policy goals in line with their competitive situation in the international market; and (c) help developing countries to design, implement and monitor FDI targeting and linkage programmes consistent with their industrialization and development strategies.* (para. 25).

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PROGRESS REPORT ON THE IMPLEMENTATION OF AGREED CONCLUSIONS AND RECOMMENDATIONS OF THE COMMISSION

Prepared by the UNCTAD secretariat

Executive summary

The note on "Improving the functioning and the structure of the intergovernmental machinery of UNCTAD" (TD/B/EX(24)/L.1), re-endorsed by the Trade and Development Board at its twenty-sixth executive session on 10 April 2001, stated *inter alia*: "Starting with the second session of each Commission, the fifth day of the session will be used for policy reviews of implementation by member States and the secretariat of the outcome of previous sessions, on the basis of documentation produced by the secretariat". Accordingly, the secretariat has prepared the present report, which contains information on the implementation of decisions and agreed conclusions adopted at the fifth session of the Commission on Investment, Technology and Related Financial Issues and addressed to UNCTAD. More information on UNCTAD's activities in the area of investment, technology and enterprise development can be found in the "DITE Activities Report 2001", submitted to the sixth session of the Commission.

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1. In accordance with the recommendations of the fifth session of the Commission on Investment, Technology and Related Financial Issues, UNCTAD continued to report on and analyse trends in cross-border mergers and acquisitions (M&As) and their share in foreign direct investment (FDI) and related policy responses. This was done particularly in the framework of the *World Investment Report 2001: Promoting Linkages* (building on the *WIR 2000*, which was devoted to the issue of M&As), in which the analysis of M&A trends was an integral part of the overall monitoring of recent trends in FDI. Furthermore, on behalf of the Government of the People's Republic of China, the secretariat undertook to organize a seminar reflecting on the implications of cross-border M&As in China (December 2001). The *WIR* website, launched in October 2000 now has about 250,000 hits per month. The text of the *WIR 2000 Overview* was downloaded 115,000 times, while the text of the *WIR 2001 Overview* was downloaded more than 33,000 times just after being published.

2. The secretariat did considerable work on the subject of competitiveness of small and medium-sized enterprises (SMEs) in the face of internationalization. The *WIR 2001* looked at a particularly interesting aspect of the subject, namely the creation of linkages between SMEs in developing countries and foreign affiliates of transnational corporations (TNCs). It analysed different approaches chosen by companies as well as Governments to promote such linkages and – on the basis of this analysis – developed specific policy options and proposed an UNCTAD linkages programme. Building partially on the findings of the *WIR 2001*, the Expert Meeting on the Impact of FDI Policies on Industrialization, Local Entrepreneurship and the Development of Supply Capacity was held in Geneva from 5 to 7 November 2001. In the framework of that meeting, the experts exchanged views and made recommendations on issues related to industrialization, export competitiveness, the development of supply capacity and FDI; the role of corporate strategies and other considerations of foreign investors/the business environment; and targeting FDI in the context of development strategies.

3. In the framework of the preparation of the *WIR 2002: FDI and Exports* the secretariat is currently pursuing work on export competitiveness as another crucial aspect of the link between FDI and the competitiveness of SMEs in the face of internationalization.

4. Pursuant to the recommendations of the fifth session of the Commission, UNCTAD continued to analyse aspects of international agreements relevant to the transfer of technology. This was done particularly in the framework of the Expert Meeting on International Arrangements for Transfer of Technology: Best Practices for Access to and Measures to Encourage Transfer of Technology with a view to Capacity-Building in Developing Countries, Especially in Least Developed Countries, which was held in Geneva from 27 from 29 June 2001. The Outcome of this meeting noted that several dozen international instruments included provisions with respect to enhancing the transfer of technology to developing countries, particularly least

developed countries, as well as their technological capabilities, and provided a list of best practices that could contribute to generating favourable conditions and opportunities for transfer of technology and capacity-building. The Outcome of the meeting will be an input for policy considerations at the sixth session of the Commission on Investment, Technology and Related Financial Issues. It was also reported to the WTO Working Group on the Relationship between Trade and Investment.

5. Furthermore, the secretariat undertook considerable work on international arrangements for the transfer of technology. It issued a *Compendium on International Arrangements on Transfer of Technology*.[1] The *Compendium* contains a selection of provisions on transfer of technology drawn from international instruments. Thus, it includes relevant excerpts from international instruments at the multilateral, regional, interregional and bilateral levels. Each of these categories contains both legally binding and non-binding instruments. Drafts, non-governmental instruments and the outcome of an UNCTAD Expert Meeting are reproduced in an annex. The *Compendium* contains an overview dealing with transfer of technology that provides a synthesis of the main challenges facing developed and developing countries alike in this field. It draws on the general context of technology transfer before analysing the important question of the implementation of the international arrangements.

6. At its fifth session, the Commission approved the provisional agenda for the eighteenth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR). Accordingly, the Group held its eighteenth session in Geneva from 10 to 12 September 2001. The main agenda item of the session was on accounting by SMEs. The Working Group held intensive discussions on proposals for realistic guidelines on accounting by SMEs drawn up by an ad hoc consultative group. The session agreed on the general approaches and requested the ad hoc consultative group to make further refinements to the proposals presented. The final output of the Group's work on accounting by SMEs is envisaged to provide guidance to policy makers and SMEs in developed as well as developing countries and countries with economies in transition. In fact, a number of policy makers stressed the need to finish the work without further delay because they urgently needed such guidance.

7. Moreover, and in accordance with the Bangkok Plan of Action and the decision taken at the seventeenth session of ISAR, participants also reviewed existing corporate governance practices, and country, company and regional codes and principles. At its closing plenary session, the Working Group proposed that it devote its nineteenth session to accounting by SMEs and corporate governance. Immediately after the eighteenth session – on 13 and 14 September – the secretariat held a two-day

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[1] *Compendium on International Arrangements on Transfer of Technology: Selected Instruments*. United Nations publication, Sales No. E.01.II.D.28, Geneva.

workshop on corporate governance. The issue was discussed from the perspectives of national and regional policy makers, regulators, the investing community, members of boards of directors and others. The workshop provided participants with an opportunity to exchange experiences, identify best practices and discuss ideas for further work on the issue by the Working Group of Experts.

8. During the reporting period, the secretariat actively participated in national, regional and international efforts aimed at capacity-building in the area of accounting and auditing. It continued disseminating the output of the Working Group of Experts on environmental accounting and requirements for professional qualifications by organizing and/or participating in national and regional workshops. It also made available to all interested persons, via its website, all reports and other documentation of the Working Group from the past three sessions.